ISSN 1429-2939

4(69) 2017

BEZPIECZNY BANK

BANK GUARANTEE FUND

SAFE BANK is a journal published by the Bank Guarantee Fund since 1997. It is devoted to issues of financial stability, with a particular emphasis on the banking system.

All articles published in “SAFE BANK” are reviewed.

All articles present the opinions of the authors and should not be construed to be an official position of BFG.

PUBLISHER:
Bank Guarantee Fund
ul. Ks. Ignacego Jana Skorupki 4
00-546 Warszawa

SECRETARY:
Ewa Teleżyńska, Małgorzata Polak
Telephone: 22 583 08 78, 22 583 05 74
e-mail: ewa.telezynska@bfg.pl; malgorzata.polak@bfg.pl

www.bfg.pl

DOM WYDAWNICZY ELIPSA

Typesetting and printing by:
Dom Wydawniczy ELIPSA
ul. Inflancka 15/198, 00-189 Warszawa
tel./fax 22 635 03 01, 22 635 17 85
e-mail: elipsa@elipsa.pl, www.elipsa.pl

Safe Bank DOI: 10.26354/bb.7.4.69.2017
4(69)/2017

Ewa Miklaszewska*

THE APPLICATION OF THE BAIL-IN TOOL IN THE BANK RESOLUTION FRAMEWORK: THE EVIDENCE FROM THE ITALIAN LOCAL AND REGIONAL BANKS

INTRODUCTION

The 2007–2009 financial crisis revealed many weaknesses of the banking industry and showed the high degree of interconnectedness of markets and existence of banks "too big to fail", whose failure would have dramatic consequences to the economy. Before the crisis, there was a lack of a consistent bank resolution framework, both in the EU and in the Member States. The rescue of failing banks was based on bail-outs of large banks, providing them with guarantees and loans from governments. Post-crisis bank regulations recognised the need for a creation of a formalized resolution framework which would allow for efficient resolution of large banks, with limited use of public funds. Thus, the purpose of this article is to discuss the key elements of bank resolution framework under the Single Resolution Mechanism (SRM) and Bank Recovery and Resolution Directive (BRRD) and to assess its impact, based on the preliminary empirical evidence[1]. The paper attempts to demonstrate that the new European resolution framework contains some serious political and social weaknesses, when it is applied to small

* Ewa Miklaszewska works at the Departament of Finance at the Cracow University of Economics.
1 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.

banks or bank networks, such as the cooperative sector, and the Italian banking market is the case in the point.

The paper is organized as follows: the Section 2 provides the overview of the European resolution framework, the Section 3 describes the consequences of the framework for the European cooperative banks, the Section 4 and 5 describe the resolution problems of the Italian cooperative local and regional banks, and the section 6 concludes the paper.

1. THE BANK RESOLUTION FRAMEWORK IN THE EU

Following the financial crisis, the EU has changed the way banks are supervised and resolved in Europe, by creation of the Banking Union, which is currently built on two pillars: the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), with the third pillar in the form of the European Deposit Insurance Scheme (EDIS) to be implemented. The key objectives of the SRM are to ensure continuation of the critical functions of rescued institutions, protection of depositors and to limit the need for public support in the form of a bank bail-out. The SRM is based on the Bank Recovery and Resolution Directive (BRRD, 2014), which provided for a creation of the resolution authority. In the Banking Union, this role was assigned to the Single Resolution Board (SRB), responsible for preparation of resolution plans for the Eurozone's significant and cross-border institutions, which are under supervision of the ECB. The SRB decides also on usage of the Single Resolution Fund (SRF) which is financed by the banking industry. The SRF became operational at the beginning of 2016 and will be gradually built up based on contributions from banks until 2024. The BRRD requires also each Member State to designate the National Resolution Authorities (national central banks or other administrative authorities)[2].

The BRRD describes a set of resolution tools which could be used by the resolution authorities to resolve the troubled banks, such as:

- ❖ sale of business;
- ❖ bridge institution – a temporary structure, where the key and critical functions of a failing bank are transferred;
- ❖ asset separation, in the form of a "good bank" and "bad bank";
- ❖ bail-in tool which allows the resolution authorities to convert the eligible banks' liabilities into loss-absorbing common equity or even completely write them off[3].

2 World Bank Group (a), *Bank Resolution and Bail-in in the EU: Selected case studies pre and post BRRD*, FinSAC, November 2016.

3 T. Philippon, A. Salord, *Bail-ins and Bank Resolution in Europe – A Progress Report, International Center for Monetary and Banking Studies*, Geneva Reports on the World Economy Special Report 4, March 2017.

The new resolution framework does not prohibit the public support. The use of public funds is possible, but only as the last resort measure, when the resolution tools were already used. Moreover, the need to safeguard the financial stability has resulted in the exclusion of some liabilities from the bail-ins, such as:

- ❖ deposits protected under the deposit guarantee scheme, up to €100,000;
- ❖ secured liabilities, including covered bonds and other guaranteed instruments;
- ❖ liabilities resulting from holding of customers' goods, for example the contents of safe deposit boxes or securities held in a special account;
- ❖ interbank liabilities (except for those within the same banking group) with an original maturity of less than 7 days;
- ❖ liabilities deriving from participation in payment systems with a residual maturity of less than 7 days;
- ❖ liabilities to employees, commercial claims and tax liabilities, if these are privileged under the bankruptcy law.

Losses that have not been absorbed by the creditors can be transferred to the resolution fund, which can intervene up to the ceiling of 5% of the total liabilities, provided that a minimum bail-in of 8% of the total liabilities has been applied. The loss bearing should start with the shareholders, then the creditors and finally the uninsured depositors.

2. RESOLUTION CHALLENGES FOR LOCAL AND REGIONAL BANKS

The SSM and SRM regulations gave a strong incentive to centralize the European cooperative banking networks, either by forming the Institutional Protection Schemes (IPS), or by giving new powers to the central institution in the network[4]. From a historical perspective, there were two main types of cooperative network models: the centralised and the decentralised one (the table 1). The basic model, where the cooperation among the members is limited and the cooperative banks jointly own a central institution, which typically ensures the liquidity of the network, cash earning, access to the national central bank and to financial markets, is slowly disappearing. Until recently, it was characteristic mostly for Poland and Spain, but the IPS has recently been instituted also in those countries. In the decentralised models, the post crisis restructuring was based on a reform towards centralizing the network, such as the reform of Italian Banche Popolari (BP) in 2015 and Banche di Credito Cooperativo (BCC) in 2016, or the implementation of the IPS in Spain or in Poland. Today, the majority of cooperative groups in Europe presents an integrated model, with a common brand, advertising and products. Co-

[4] World Bank Group (b), *Understanding Bank Recovery and Resolution in the EU: A guidebook to the BRRD*, FinSAC, November 2016.

operative groups are generally characterized by an inverted pyramid structure: the local banks own the central institution and its specialized subsidiaries, contrary to the holding company, which owns all local branches and the subsidiaries within the group[5]. Some co-operative networks are organized as a two-tier system, while others as a three-tier ones: local banks-regional banks-central body (table 2).

Table 1. Main European cooperative models

Basic	Decentralized	Consolidated/Integrated
• lack of mutual guarantees or an IPS, • weak competences of the central institution, • local banks supervised by the external regulator.	• IPS, • week competences of the central institution, • local banks supervised by an external regulator.	• mutual guarantees, • supervision by the ECB, • many functions centralized on a group level, • decision of the central institution are binding.

Source: H. Groeneveld, *Governance of European Cooperative Banks: Overview, Issues and Recommendations*, TIAS Working Paper, Sept. 2015.

Table 2. The typical structures of European cooperative networks

Local banks' competences	Network model	Main source of financing
Local banks with a full licence.	1, 2 or 3-level structure.	Reinvested profits.
Local banks represented by a central institution.	Central institution in the form of a joint stock company, cooperative, association.	Local deposits.

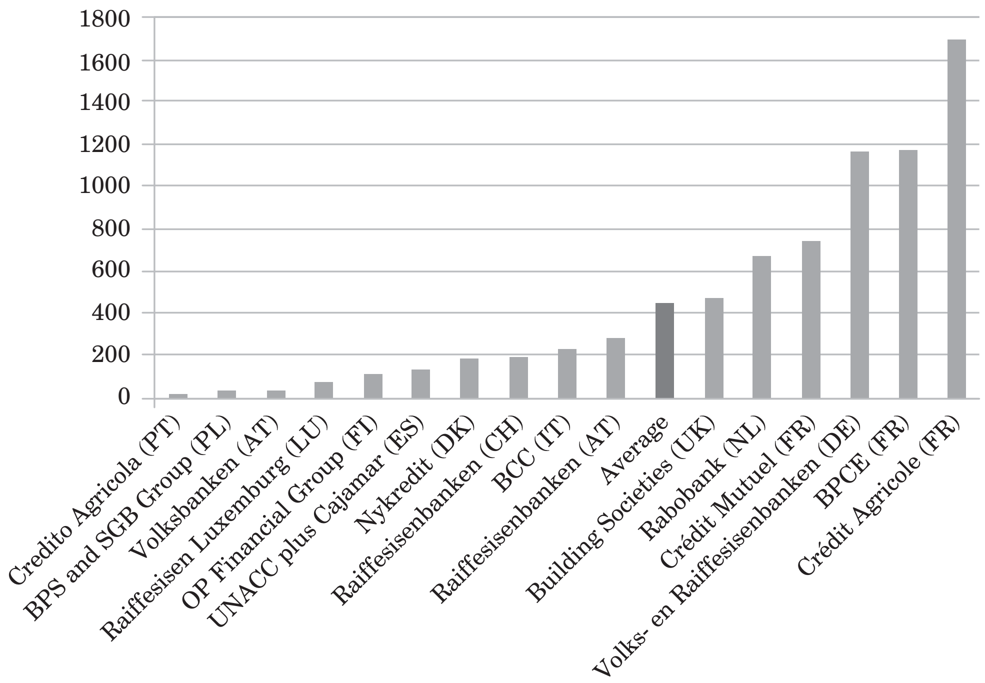
Source: H. Groeneveld, *Governance of European Cooperative Bank…*, *op. cit.*

The decentralized structures forms a network with an IPS, where banks entered into a contractual or statutory liability arrangement which protects the local co-operative banks and ensures their liquidity and solvency (which grants a 0% risk weight of intra-group exposures). The IPS must be able to grant support from readily available funds, and be able of monitoring and classification of risks. However, as regards their operational business, the banks in the network remain to a large extent independent. This system is characteristic for BVR Group in Germany, Fachverband der Raiffeisenbanken in Austria and is in the process of establishment in Italy (BBC Group) and by the two cooperative networks in Poland[6]. In an integrated cooperative network, local cooperative banks and the

5 EACB: European Association of Cooperative Banks: *Annual Report 2016*, Brussels, 2017.
6 EACB: *The Cooperative Difference: Sustainability, Proximity, Governance*, 2016.

central body are linked by a parent-subsidiary relationship which is characterized by a higher level of control of the central institution (which also allows a 0% risk weight for intra-group exposures) and there is no impediment to the transfer of own funds or repayment of liabilities from the central body to the local banks. This system is characteristic for the cooperative groups in France (Credit Agricole, Credit Mutuel, BPCE). The last stage of centralisation is the consolidated co-operative group, where the central institution and the local banks form one bank and the supervisors focus only on the consolidated level. This model applies to the OP Pohjola Bank in Finland and to the Rabobank in the Netherlands. The concentrated cooperative groups dominate the European cooperative sector in terms of the total assets (the figure 1).

Figure 1. Assets of European cooperative groups, 2015



Note: the Italian BPs are excluded from the figure, as they have largely converted to public liability companies, which was required by the Italian law of 2015.

Source: H. Groeneveld, *Snapshot of European Cooperative Banking*, TIAS Working Paper, 2017.

The reforms of the cooperative networks towards centralization were instituted either bottom-up (Germany, the Netherlands, Finland) or they were implemented top-down by the authorities, often because of a poor financial condition of the cooperative groups (Italy, Spain). In the decentralised cooperative systems, the post crisis restructuring was based either on the centralization of the network, or on the implementation of the Institutional Protection Schemes (IPS) (tables 3 and 4).

Table 3. Examples of IPS in the Eurozone, 2015

Country	IPS
Germany	• Sparkassen-Finanzgruppe (DSGV, assets of 2 800 bil.) • Genossenschaftliche FinazGruppe Volsbanken Raiffeisenbanken, (BVR, assets of 1 163 bil.)
Austria	• Erste Group (assets of 200 bn) • RZR Group (Raiffeisen banks) (assets of 138 bn) • Volksbanken (assets of 28 bn)
Spain	• Crupo Cooperativo Cajamar (assets of 40 bn) • Crupo Cooperativo Solventia (assets of 1.6 bn)

Source: C. Choulet, *Institutional Protection Systems: Are They Banking Groups?*, economic-research. bnpparibas.com, January 2017.

Table 4. Polish cooperative banks according to their affiliation, Sept. 2016

Type of affiliation	IPS_1 (BPS Group)	IPS _2 (SGB Group)	Newly created integrated network (basic model)	Undecided banks	Independent cooperative banks	Total
No. of banks	273	197	56	30	3	559

Source: KNF, Warszawa, 12.2016.

3. THE RESOLUTION OF THE ITALIAN LOCAL BANKS IN 2015

In Italy, The Consolidated Law on Banking of 1993 granted the Bank of Italy supervisory powers for banks, banking groups, financial companies, e-money institutions and payment services' providers, currently under the framework of the Single Supervisory Mechanism (SSM), which has been fully operational since November 2014. The Consolidated Law on Finance of 1998 assigned the supervisory tasks to the Bank of Italy for securities investment firms and asset management companies; together with the Companies and Stock Exchange Commission (Consob), which oversees the transparency and fairness of investment practices. The rules for managing bank crises were modified by the Legislative Decree in 2015, transposing the Bank Recovery and Resolution Directive (BRRD) into the Italian law. The Single Resolution Mechanism (SRM) became fully operational on 1 January 2016. The Bank of Italy has been designated the National Resolution Authority. The Bank of Italy voiced its opposition, unsuccessfully, in a consultation procedure on the bail-in tool, in the form of a paper to the European Council submitted in March 2013, where it called for a 3-year transition period (until 2018) to allow banks to gradually build up the cushion of liabilities (the MREL) needed to absorb the bail-in losses, to be offered to knowledgeable investors.

In Italy, the overall bank performance is poor and the unresolved problem is that of the non-performing loans (NPLs), on average 16% of the loan portfolio, comparing to 5.4% of the EU average in 2016[7]. Also the GDP growth is very low: according to a Moody's forecast, below 1% for the 2016–2018 period. The European Banking Authority's (EBA) Report points to the low growth and the high NPL ratio as the major threats for the European banks, and both problems are significant in Italy[8].

According to the BRRD's rules, the future problems of the Italian banks will have to be solved using the bail-in tool. However, this may be politically difficult, as in Italy bank bonds are largely owned by small investors, and members of cooperatives are not interested in participating in bank governance (the table 5). Consequently, the Italian government has tried to avoid resolution procedures as long as possible, postponing the full entry into force of the bail-in provision to 2016, applying before this date only some burden-sharing systems.

Table 5. Deposits and bonds issued by the Italian banks: (a) billions of euros, (b) % of household wealth

<table>
<tr><th rowspan="3"></th><th rowspan="2" colspan="2">Bank debt instruments</th><th colspan="6">Subject to bail-in</th><th colspan="4">Not subject to bail-in</th></tr>
<tr><th colspan="2">Subordinated bonds</th><th colspan="2">Senior unsec. bonds</th><th colspan="2">Deposits above 100 000 EUR</th><th colspan="2">Deposits below 100 000 EUR</th><th colspan="2">Senior covered bonds</th></tr>
<tr><th>a</th><th>b</th><th>a</th><th>b</th><th>a</th><th>b</th><th>a</th><th>b</th><th>a</th><th>b</th><th>a</th><th>b</th></tr>
<tr><td>2008</td><td>994</td><td>26.4</td><td>27</td><td>0.7</td><td>330</td><td>8.7</td><td>183</td><td>4.9</td><td>454</td><td>12.0</td><td>0.0</td><td>-</td></tr>
<tr><td>2011</td><td>1017</td><td>28.6</td><td>25</td><td>1.0</td><td>341</td><td>9.6</td><td>184</td><td>5.2</td><td>457</td><td>12.9</td><td>0.4</td><td>-</td></tr>
<tr><td>2015</td><td>921</td><td>22.9</td><td>29</td><td>0.7</td><td>173</td><td>4.3</td><td>225</td><td>5.6</td><td>493</td><td>12.3</td><td>0.1</td><td>-</td></tr>
</table>

Source: Bank of Italy: FSR, 2016/1.

Historically, there were two cooperative networks in Italy: BP and BCC, although the former group had a complex governance structure, allowing BP banks to float

[7] Businessinsider, www.businessinsider.com/statistics-non-performing-loans-npls-italy-banking-system-2016-11; J. Garrido, *Insolvency and Enforcement Reforms in Italy*, IMF Working Paper WP/16/134, July 2016.

[8] EBA: *Risk Assessment of the European Banking System*, Dec. 2016.

part of their capital on the exchange, directed towards not voting members. Poor economic condition of the Italian cooperative groups, both BP and BCC (table 6), was a central point in the reform program of the Italian banking system instituted by the Italian government in 2015 and 2016[9].

Table 6. Financial characteristics for the Banco Popolare group

	2010	2011	2012	2013	2014
loans from clients, mil. Eur	94 462	93 349	91 481	86 149	79 823
deposits, mil. Euro	104 524	100 200	94 506	90 018	86 513
net profit, mil. Euro	308	-2 258	-944	-606	-1 946
ROA (%)	0,24	-1,71	-0,73	-0,49	-1,61
ROE (%)	2,68	-23,96	-10,51	-7,11	-24,10

Source: ECB: Financial Data Warehouse.

In 2015, the reform of the BP group started, aiming at converting the largest BP into joint stock companies. According to the Italian Law N°3/2015, 10 largest Banche Popolari, with assets above 8 bn euro, representing 90% of loans, employment and branches of the group, had to demutualize within 18 months[10] (table 7).

Table 7. Largest BP (assets, bn EUR)

Banco Popolare	126,0
UBI Banca	123,2
Banca Popolare dell'Emilia Romagna	60,9
Banca Popolare di Milano (BPM)	48,8
Banca Popolare di Vicenza (BPVI)	46,1
Veneto Banca	37,9
Banca Popolare di Sondrio	33,0
Credito Valtellinese	26,9
Banca Popolare dell'Etruria e del Lazio	12,5
Banca Popolare di Bari	10,4

Source: Scope ratings, 26.01.2015, www.scoperatings.com.

9 MEF: *Italian Banking Sector: Recent Developments and Reforms*, http://www.mef.gov.it/focus/sistema_bancario/ITALIAN_BANKING_SECTOR.pdf.

10 https://www.thenews.coop/93102/sector/banking-and-insurance/why-italys-peoples-banks-are-not-co-operatives-anymore [accessed: 25.04.2017].

The reform was partially aborted after the constitutional referendum in December 2016 resulted in a clear "no" vote for the fundamental reforms proposed by the Prime Minister Matteo Renzi, and his subsequent resignation. But most of the largest BP banks had already demutualized, and the group consolidated. The largest BP bank – Banco Popolare Società Cooperativa, merged in 2016 with Banca Popolare di Milano, creating a joint stock company. Ultimately, it would be the third Italian bank with assets above €170 bn, 4 mn clients and 25 ths. of employees[11].

In July 2015, during the liquidation process of Banca Romagna Cooperativa, a small Italian mutual bank, shareholders and junior bondholders were "bailed- in" but did not suffer any loss as the Italian mutual sector's Institutional Guarantee Fund decided to reimburse them to preserve the reputation of the sector. In November 2015, there was a resolution of four small banks: Banca delle Marche, Banca dell'Etruria e del Lazio, Cassa di Risparmio di Chieti, and Cassa di Risparmio di Ferrara. The resolution of those banks aimed at business continuity and financial recovery, in the interests of the local economies. It fully protected the savings of households and local firms in the form of deposits, current accounts and ordinary bonds; it preserved the jobs of banks' employees, and it required no public funds. The banks' cumulative losses were absorbed by the riskiest investment instruments: shares and subordinated bonds. Full bail-in would have required also absorption of losses on the part of senior bondholders and unprotected depositors.

The solution used for those banks consisted of the following elements[12]:

- bail-in of equity and subordinated debt: €798 mil. losses were imposed on junior bondholders, of which around half were held by retail investors;
- each of the four banks was split into "good or bridge banks" and a single "bad bank" containing toxic assets of all four banks;
- the capital of "good banks" was reconstituted by the Resolution Fund in the amount of approximately 9% of total risk-weighted assets. The Resolution Fund is administered by the Bank of Italy's Resolution Unit and is financed with contributions from the entire Italian banking system;
- the "bad bank" (not a licensed bank) took possession of all the bad toxic assets remaining after the absorption of the losses. The Resolution Fund also supplied the bad bank with the requisite capital endowment;
- the Resolution Fund's financial outlays of €3.6 bn were injected to "good banks" (€1.8 bn.) and €1.7 bn was used to write down banks' bad debt, as well as to set up the bad bank, and the liquidity required for the rescue was advanced by three major banks: Intesa, Unicredit, and UBI;

11 http://www.eacb.coop/en/news/members-news/bcc-the-reform-of-the-co-operative-banks-in-italy-is-now-law.html [accessed: 25.04.2017].

12 http://www.bancaditalia.it/media/approfondimenti/2015/info-soluzione-crisi/index.html [accessed: 25.04.2017].

❖ the good banks kept the original names, adding the suffix "Nuova". The banks will temporarily be administered by BoI, and the bridge banks were to be sold quickly. The proceeds of the sales would be retained by the Resolution Fund;
❖ the rescued banks voluntarily established a fund that will be attached to the national deposit insurance scheme to compensate a large number of retail investors that were bailed-in.

The State sustained no direct cost in the process. The entire cost was borne first by the four banks' shareholders and subordinated bondholders, but ultimately by the Italian banking system as a whole through its contributions to the Resolution Fund.

In 2016, the reform of the second cooperative network BCC has started, aiming at the centralization of the 367 banks and creation of the IPS-type of arrangement[13]. To solve the rescue problems in case it is applicable to larger banks, particularly in relation to the NPLs, in 2016 a special fund was created: *Guarantee on Securitization of Bank Non-Performing Loans* (GACS), with governmental guarantees, supported by a bank-financed fund Atlante (Altante). In 2016, the Atlante fund had to recapitalize two large banks from Popolari group (Banco Popolare di Vicenza and Veneto Banca), which were unable to be recapitalized from private sources. The recapitalization, based on acquiring 90% of the banks' capital by the Fund, depleted it from capital[14]. In result, the Fund has protected some small Italian banks from "resolution" procedures, which was required by the political and social factors, but with side consequences of transmitting the risk to the whole sector.

4. THE RESOLUTION OF THE ITALIAN REGIONAL BANKS – "THE VENETO BANKS" – IN 2017

Banca Popolare di Vicenza and Veneto Banca (often called "the Veneto banks") have been operated in the prosperous Veneto region in north-east Italy. Since 2014, both were directly supervised by the ECB, as at the end of 2016 they were Italy's 10th- and 11th-biggest banks by assets. Due to the law of 2015, the banks demutualized. Veneto Banca S.p.A. changed from a cooperative society to a limited company. Following a failed stock market listing in June 2016, it was taken over by a bail-out fund Atlante, which has prevented its resolution. Both banks became insolvent again in 2017. Banca Popolare di Vicenza (BPVI) was among the four Italian banks (together with Banca Popolare di Milano, Banca Carige and Banca

[13] Banca d'Italia FSR 2016/1.

[14] S. Merler, *Italian Banks: Not Quiet on the Eastern Front*, http://www.dt.tesoro.it/en/news/ news_gacs.html [accessed: 31.03. 2017].

Monte dei Paschi di Siena) that failed the ECB stress tests in 2014. Both BPVI and Veneto Banca have a very high amount of non-performing loans (37%, compared to the Italian average of 18%) and high operating costs. They have been loss-making for a number of years and between June 2015 and March 2017 the banks lost 44% of their deposit base[15].

On 23 June 2017, the European Central Bank and the Single Resolution Board determined that both BPVI and Veneto Banca were insolvent, but did not fulfilled the criteria to put them in resolution. The SRB explained that it was not in the public interest to put them into resolution, as they did not have a significant impact on the financial stability. Consequently, they have been liquidated under Italian insolvency law, at the estimated cost of €17 billion. Italy determined that the winding up of these banks would have a serious impact on the real economy in their region, hence Italy notified to the EU Commission on its plans to grant State aid to wind-down BPVI and Veneto Banca – to sell parts of the two banks to Intesa, including the transfer of employees. In particular, the Italian State granted the following funds:

- ❖ cash injections of about €4.8 billion;
- ❖ state guarantees of a maximum of about €12 billion, notably on Intesa's financing of the liquidation mass.

The European Commission approved the state aid to Intesa and the good assets of the failing banks (performing loans, financial assets, deposits and the senior debt) were sold to Intesa Sanpaolo for one euro, and the rest was put into a "bad bank" with the bail-in of equity and subordinated shareholders, which remained in the entity into liquidation. As part of the "bail-in" rule, the Atlante Fund (with Intesa San Paolo and Unicredit as the two main shareholders), other shareholders, and subordinated bondholders received nothing. Moreover, Intesa announced that together with Unicredit they would establish a fund to repay the bonds that were held by small investors (€200 million in junior bonds)[16].

To conclude, the Italian banking system had spent over €4 billion in mandatory contribution to the resolution of 4 small banks between 2015 to 2017 and made an "investment" of over €4 billion in the Atlante rescue fund dealing with the bad debt of the Veneto Banks. Both cases raised the question of how to deal with retail bondholders. The two Venetian banks were supposed to be healthy after Altante recapitalised them in 2016, but they were not. If the resolution procedures had been applied, it would have required bailing in senior bondholders, which in the Italian case includes a large number of retail clients. Intesa San Paolo solved

---

15 The Economist, *The complicated failure of two Italian lenders*, July 1st, 2017, www.economist.com.

16 European Parliament (IPOL, EGOV), *The Orderly Liquidation of Veneto Banca and BP di Vincenza,* http://www.europarl.europa.eu/ 2017.

the problem by buying the "good" parts of the two Veneto banks for a symbolic sum of 1 euro. All the NPLs, equity and junior debt were bailed in. The equity was mostly held by the Altante fund. Junior bondholders – about 200 million – were bailed-in but will be reimbursed afterwards. This operation was possible because the banks were not resolved but liquidated, thus eligible for an liquidation aid as liquidation is processed under the national insolvency law. In November 2015, when the Bank of Italy imposed losses on bondholders of four small local banks, a customer of Banca Etruria committed suicide after losing his life savings. This was why when MPS, Veneto Banca and Banca Italia di Vicenza entered difficulties, the SRM was not applied. The Italian government has since intervened to bail out MPS and provide guarantees to the two other banks at a cost to the taxpayer of €18 billion.

CONCLUSIONS

The 2007–2009 financial crisis has revealed a number of issues related to failing banks, such as absence of resolution strategies and plans, a lack of designated authorities capable of dealing with failing banks, absence of cross-border coordination. In response to the identified problems and following recommendations from global regulatory bodies, the EU has undertaken number of initiatives aimed at creation of a comprehensive resolution framework. The new laws are aimed at providing the EU with a strong foundation for effective resolution. The framework was built on resolution authorities that received the mandate and tools to execute resolution strategies and plans. The resolution mechanisms allow for proper funding and should in theory result in no or minimum use of taxpayers' funds. However, a number of challenges emerged. Resolution regime is a result of a cost–benefit optimization and the resolution-related decisions must balance interests of various stakeholders[17].

There were not many cases of applying the resolution process to large banks after the BRRD, however, there were some instances of dealing with relatively smaller ones, particularly in Italy. The resolution regulation contains strict limitation on the state aid, which can be used only in exceptional circumstances, and after the bail-in of the junior debt. However, in Italy, about one third of bank bonds are held by households, so even a limited bail-in can have painful political and social consequences[18]. Investors who suffers from bail-in, in the case of Italy to

17 M. Dewatripont, J. Tirole, J.C. Rochet, *Balancing the banks. Global lessons from the financial crisis*, Princeton University Press, Princeton 2010.

18 N. Jassaud, *Reforming the Cooperative Governance of Italian Banks*, IMF Working Paper WP/14/181, Sept. 2014.

a large extent households, have a little comfort in the fact that they are protected as taxpayers.

To safeguard the economic and social stability, privately-owned (mostly by banks) funds were created to compensate the bail-ined stakeholders and to protect some small Italian banks from resolution procedures in the future. However, the possible consequence is the creation of the systemic risk to the whole sector. Hence there are voices calling for more flexibility in applying the resolution tools, particularly the bail-in rule[19]. The BRRD scheme was designed for large, systematically important banks and extending all tools and procedures in a rigid manner to the whole banking sector, including cooperative banks and their networks, may create some unresolved political and social problems.

Abstract

Post-crisis bank regulations recognised the need for a creation of a formalized resolution framework which would allow for an efficient resolution of troubled banks, with no or limited use of public funds. However, the resolution schemes are based on complex procedures, which aim at balancing the interests of different stakeholders. The purpose of this paper is to identify and assess the key elements of the resolution framework under the Single Resolution Mechanism (SRM) and the Bank Recovery and Resolution Directive (BRRD), concentrating on the bail-in tool. In particular, the paper attempts to demonstrate that there are some serious economic and social problems, when the resolution procedures are applied to local and regional banks, such as the cooperative sector, illustrating it with the bank resolution experience in Italy.

Key words: resolution, bail-in, cooperative banks

References

Banca d'Italia, *Financial Stability Report*, 2015/2, 2016/1; 2017/1.

Businessinsider, www.businessinsider.com/statistics-non-performing-loans-npls-italy-banking-system-2016-11.

Choulet C., *Institutional Protection Systems: Are They Banking Groups?,* economic-research. bnpparibas.com, January 2017.

[19] S. Micossi, G. Bruzzone, M. Cassella, *Bail-in Provisions in State Aid and Resolution Procedures: Are they consistent with systemic stability?,* CEPS Policy Paper No. 318, 21 May 2014.

Coppola F., *Italy's Latest Bank Bailout Has Created A Two-Speed Eurozone*, Forbes, Jun 26, 2017, www.forbes.com.

Dermine J., *Europe's Single Resolution Mechanism is Creating Instability*, Insead Knowledge, October 10, 2017, https://knowledge.insead.edu.

Dewatripont M., Tirole J., Rochet J.C., *Balancing the banks. Global lessons from the financial crisis*, Princeton University Press: Princeton, 2010.

Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.

EACB: European Association of Cooperative Banks: *Annual Report 2016*, Brussels 2017.

EBA: *Risk Assessment of the European Banking System*, Dec. 2016.

EACB: *The Cooperative Difference: Sustainability, Proximity, Governance*, 2016.

The Economist, *The complicated failure of two Italian lenders*, 1.07.2017, www.economist.com.

The Economist: *Reform of Italy's biggest cooperative banks will help the sector to consolidate*, 23.01.2015, www.economist.com.

European Parliament (IPOL, EGOV), *The Orderly Liquidation of Veneto Banca and BP di Vincenza,* http://www.europarl.europa.eu/ 2017.

Financial Stability Board, K*ey Attributes of Effective Resolution Regimes for Financial Institutions*, October 2011.

Garrido J.*, Insolvency and Enforcement Reforms in Italy*, IMF Working Paper WP/16/134, July 2016.

Groeneveld H., *Governance of European Cooperative Banks: Overview, Issues and Recommendations,* TIAS Working Paper, Sept. 2015.

Groeneveld H., *Snapshot of European Cooperative Banking*, TIAS Working Paper, March 2017.

Gutiérrez E., *The Reform of Italian Cooperative Banks: Discussion of Proposals*, IMF Working Paper, March 2008.

Jassaud N., *Reforming the Cooperative Governance of Italian Banks*, IMF Working Paper WP/14/181, Sept. 2014.

KPMG: Single Resolution Board: Contrasting Outcomes for Banks, July 2017.

MEF: *Italian Banking Sector: Recent Developments and Reforms*, http://www.mef.gov.it/focus/sistema_bancario/ITALIAN_BANKING_SECTOR.pdf.

Merler S., *Italian Banks: Not Quiet on the Eastern Front*, http://www.dt.tesoro.it/en/news/news_gacs.html 31.03. 2017.

Micossi S., Bruzzone G., Cassella M., *Bail-in Provisions in State Aid and Resolution Procedures: Are they consistent with systemic stability?,* CEPS Policy Paper No. 318, 21 May 2014.

Morello L., *The Implementation of the BRRD in Italy*, The Global Financial Markets Insight, 2016/9.

Philippon T., Salord A., *Bail-ins and Bank Resolution in Europe – A Progress Report, International Center for Monetary and Banking Studies*, Geneva Reports on the World Economy Special Report 4, March 2017.

Reforming the Corporate Governance of Italian Banks, IMF WP/14/181 Sept 2014.

Schäfer A., Schnabel I., Weder di Mauro B., *Bail-in expectations for European banks: Actions speak louder than words*, ESRB Working Paper Series, No 7, April 2016.

World Bank Group (a), *Bank Resolution and Bail-in in the EU: Selected case studies pre and post BRRD*, FinSAC, November 2016.

World Bank Group (b), *Understanding Bank Recovery and Resolution in the EU: A guidebook to the BRRD*, FinSAC, November 2016.